III. VERIZON'S NONRECURRING CHARGES IN DELAWARE ARE INFLATED BY CLEAR TELRIC ERRORS.

The Commission has long recognized that cost-based nonrecurring charges ("NRCs") are critical to making competitive local telephone entry economically feasible.[19] Regardless of the level of the recurring rate, an ILEC will foreclose meaningful competition if it is allowed to increase potential competitors' costs significantly through inflated non-recurring charges. New entrant competitive carriers must pay NRCs up-front, and if NRCs are significantly overstated, then potential new entrants will not be able to afford to enter the market. Moreover, higher NRCs increase the level of market risk faced by potential new competitive local exchange market entrants because the high price of entry substantially reduces the potential competitors' pricing flexibility relative to the pricing flexibility enjoyed by the incumbent, which does not have to pay the NRCs. In Delaware, Verizon's NRCs are not even remotely TELRIC-compliant.

Bell Atlantic-Delaware (now Verizon-Delaware) first proposed UNE rates in 1997.[20] The PSC largely followed Verizon's approach of basing its NRCs on the costs of the largely manual, non-automated procedures used by Verizon, rather than the forward looking costs an efficient firm would incur to provision UNEs.

AT&T sought judicial review from the U.S. District Court in Delaware. AT&T argued that the NRCs adopted by the PSC in Order No. 4542 did not reflect the rates that

[19] *See, e.g., AT&T Communications,* 103 FCC 2d 277, ¶ 37 (1985) ("It is evident that nonrecurring charges can be used as an anticompetitive weapon to . . . discourage competitors"); Second Memorandum Opinion and Order on Reconsideration, *Expanded Interconnection with Local Telephone Company Facilities*, 8 FCC Rcd. 7341, ¶ 43 (1993) ("absent even-handed treatment, nonrecurring reconfiguration charges could constitute a serious barrier to competitive entry").

[20] Application of Bell Atlantic Delaware Inc. for Approval of its Statement of Terms and Conditions Under Section 252(f) of the Telecommunications Act of 1996, PSC Docket 96-325 (filed December 16, 1996).

an efficient LEC would provide for fully-mechanized electronic interfaces and systems for ordering, provisioning, billing, and related non-recurring operations, but rather, allowed Verizon to collect NRCs based on Verizon's inefficient and more costly antiquated manual processes.

The court agreed. In *Bell Atlantic-Delaware, Inc. v. McMahon*, 80 F. Supp. 2d 218, 250-51 (D. Del. 2000) ("*McMahon*"), the court found that the Verizon NRCs set by the Delaware PSC in 1997 violated the 1996 Act and the Commission's rules because the rates were based on Verizon's existing, inefficient processes. The court rejected the very same arguments that Verizon had advanced before the PSC – that Verizon's NRCs were "forward-looking" even though they were based on Verizon's embedded processes for providing UNEs. The court explained:

> The mechanization of Bell's current internal service order processes is irrelevant to the legal standard for determining network element costs. At no point in their analysis did the Hearing Examiner's address Bell's proposed NRC charges in light of "the most efficient telecommunications technology currently available and the lowest cost network configuration." 47 CFR §51.505(b)(1). There is simply no mention of the "most efficient, currently available" telecommunications technology – even though the Commission since has conceded that Bell's service order processing system does not meet this standard . . . . Where, as here, an agency ignores a controlling legal standard, its rulings are arbitrary and capricious. *See Florida Power Light Co.* 470 US at 743.

McMahon, 280 F. Supp. 2d at 251.

Recognizing that the PSC would need to develop a factual record to determine the forward looking costs that an efficient carrier would incur to provide the services, the court "remand[ed] the NRC charge issue for renewed evidentiary hearings consistent with the *Local Competition Order* and its implementing regulations, specifically, 47 CFR

§51.505(b)(1)." *Id.* The court expressly prohibited the PSC from relying on Verizon's current processes as a basis for determining NRCs. *See McMahon*, 80 F. Supp. 2d at 251 ("[t]he mechanism of [Verizon's] current internal service order processes is *irrelevant* to the legal standard for determining network element costs") (citing 47 C.F.R. § 51.505(b)(1)).

Despite these instructions in *McMahon*, the NRCs proposed by Verizon in 2001 were, in the unanimous judgment of the PSC's Staff, the Department of Public Advocate and the PSC's own hearing examiner, still based on Verizon's existing processes.[21] Indeed, in many respects, the "new" Verizon NRCs were a step backwards; NRCs for many key processes were *higher* than those that had been struck down in *McMahon*.[22]

As explained by the attached declaration of Richard Walsh, Verizon based its Phase II nonrecurring charges on a "new" Non-recurring Cost Model ("NRCM"), which purported to measure the "forward-looking" costs of the tasks necessary to provide UNEs. Like Verizon's Phase I NRC study, however, Verizon's "new" study took as its starting point Verizon's existing systems. Generally speaking, the NRCM was based on surveys of the time Verizon's employees took to provision certain UNEs, utilizing existing systems and processes. The survey responses were then averaged and adjusted by an unnamed "panel of experts" who made undocumented "forward-looking adjustments." The PSC's own Staff described Verizon's jury-rigged methodology as follows:

> 1. Assume that current systems, processes, work activities, and work times represent the appropriate baseline for a study of forward-looking economic costs calculated pursuant to the TELRIC standard;

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[21] *See* Findings and Recommendations of the Hearing Examiner on Remand (Feb. 28, 2002) ("Hearing Examiner Remand Findings"); Staff's Initial Mem. on Remand (Feb. 15, 2002); Public Advocate's Comments & Recommendations Concerning Remand Issues, at 4 (Feb. 15, 2002).

[22] April 30, 2002 Meeting Tr. at 2384-85.

> 2. Conduct surveys of employees performing tasks using existing systems.
>
> 3. Compile the results, creating an "average of averages;"
>
> 4. Through the operation of a panel of unnamed experts whose operation is completely undocumented, make any changes deemed necessary to ensure the data accurately reflects the panel's assumptions regarding existing tasks and task times;
>
> 5. Through the operation of a panel of unnamed experts whose operation is completely undocumented, make any changes deemed necessary to ensure the data accurately reflects the panel's assumptions regarding how Verizon's existing systems and processes will be improved in the future; and, then,
>
> 6. Calculate non-recurring costs based on these unsupported assumptions.

Staff's Initial Mem. on Remand, at 9 (Feb. 15, 2002) (footnote omitted).

AT&T, on the other hand, advocated forward-looking NRCs based upon the processes that would be used by an efficient carrier unconstrained by an outdated legacy system. *See* Prefiled Testimony of Richard Walsh (Sep. 14, 2001). Accordingly, AT&T's proposed NRCs were well below those proposed by Verizon. Walsh Decl. ¶ 22.

The Hearing Examiner issued Findings and Recommendations on December 21, 2001 (the "Initial Report"), finding that AT&T's NRC cost model was "forward-looking." Initial Report ¶ 247. He also found "understandable" the uniform criticism of Verizon's study. *Id.* Nevertheless, he declined to recommend AT&T's model, instead recommending that the PSC adopt the Verizon's NRCM. According to the Hearing Examiner, by adjusting its existing processes to reflect future improvements, Verizon made a "good-faith" effort to reflect a forward-looking environment. *Id.*

On February 19, 2002, the PSC met to deliberate and consider the Hearing Examiner's Initial Report. The PSC was unable to reach a decision on the NRCs, noting that "the record developed by the parties is not, in the Commission's opinion, sufficient to allow the Commission to render an informed decision on the issue of whether Verizon-Delaware's non-recurring cost model complies with the District Court's determinations and TELRIC and whether the rates produced are just and reasonable under the TELRIC's pricing standards." Order No. 5896 at 1.

On remand to the Hearing Examiner, PSC Staff, the Public Advocate, Cavalier, and AT&T showed that Verizon's use of existing processes and times (even "adjusted" for future efficiencies), constituted the exact approach rejected by the District Court. The parties criticized extensively the premises, procedures, inputs, and assumptions made in the development of the model and the resulting NRCs and made clear that while Verizon's NRCM was labeled as "forward-looking" it was actually an embedded historical cost study. *See, e.g.*, PSC Staff Reply Mem. on Remand, at 5 (Feb. 21, 2002).

In this regard, the parties demonstrated that Verizon's model assumed only those incremental changes that Verizon planned to make to its existing *legacy* processes, and did not, as required by the TELRIC rules, estimate the costs of the most efficient processes that could be used to provide UNEs to competitors. *See, e.g.*, Public Advocate's Comments & Recommendations Concerning Remand Issues, at 4 (Feb. 15, 2002). For example, Verizon assumed that new service orders for UNEs by competitive carriers would require costly manual processing 23% of the time, despite the fact that efficient ordering systems are available that would all but eliminate the need for such manual processing. Supplemental Filing of AT&T, at 10 (Nov. 28, 2001). And it was precisely because of these fundamental flaws that Verizon's "new" NRCs were for the most part higher than the "old" NRCs that all acknowledge were improperly based on inefficient processes. April 30, 2002 Meeting Tr. at 2384-85.

The PSC's own Staff agreed that the focus of Verizon's new NRCM study remained embedded or short run. "Verizon has been candid in representing: (1) that the starting point for [its cost study] process was the design of its *current* systems and the work tasks associated with those systems and (2) that adjustments were made to reflect expected enhancements to these systems, based on the opinions of a panel of in-house experts whose expertise lie in Verizon's existing processes, existing systems, and the company's existing plans to mechanize those systems." Staff's Initial Mem. on Remand at 6.

The parties also showed that Verizon did not even measure its embedded costs properly. Verizon calculated its NRCs by relying on a survey of the time employees said they spent performing the tasks necessary for provisioning UNEs. While Verizon represented that this survey was conducted by Andersen Consulting, that was not the case. *Id.* Rather, Andersen conducted a survey at a later date than the internal Verizon survey that was used and the Andersen survey generally measured shorter times than the survey that Verizon used. Order No. 5967 ¶ 88. Finally, the parties demonstrated that Verizon's study was a "black box" with no evidence supporting the adjustments Verizon made to transform existing inefficient processes into efficient, forward-looking processes. *See, e.g.*, AT&T Reply to Verizon's Br. on Remand, at 4-7 (Feb. 21, 2002).

On February 28, 2002, the Hearing Examiner issued a ruling that reversed his earlier recommendation on the NRC issue, frankly acknowledging that he had erred in previously determining that the Verizon NRCM produced TELRIC-compliant rates. In his decision, the Hearing Examiner explained:

> 18. My [original] Recommendation in favor of the NRCM was based on two underlying conclusions. First, based on PSC Order No. 5735, I concluded that the Commission purposely limited the scope of this proceeding by creating certain presumptions in favor of the Phase I

inputs and by establishing an expedited schedule. Second, I concluded that Verizon-Delaware's broad interpretation of TELRIC and the District Court remand was a supportable position and that its NRCM was consistent with such interpretation, notwithstanding the other parties' protests that a TELRIC based model cannot start with embedded technology and processes and that the record support for the inputs to the NRCM was inadequate.

19. On remand, however, these two conclusions are called into question. First, in its deliberations, and as reflected in the remand itself, the Commission understandably shows a reluctance to set "permanent" UNE rates in a limited proceeding and reveals a preference to err in favor of full development of the record. In addition, the Commission's rationale for expediting this proceeding in the first instance may now be moot. An express purpose for expediting the proceeding was to facilitate Verizon-Delaware's entry into the long distance market in Delaware by providing a full set of permanent UNE rates for inclusion in Verizon-Delaware' imminent 271 filing. Order No. at 5735 at 6. Verizon-Delaware, however, recently filed for its Section 271 review in Delaware and apparently intends to move forward with its FCC application, irrespective of the status of this UNE proceeding.

20. Second, on remand, Staff points out that Verizon-DE has argued before the U.S. Supreme Court that TELRIC is not the flexible version ("TELRIC Light") it supports in this case. [Staff Initial Brief at 2]. Rather, to support its position that TELRIC results and consistent rates, Verizon-Delaware has argued that TELRIC requires rates based solely on a network of available, but yet to be deployed, technology and processes. This interpretation is, of course, in line with Staff and AT&T's more rigid version of TELRIC. I agree with Staff that Verizon-Delaware's inconsistency in its interpretation of TELRIC weakens its position in this case.

21. In addition, Staff notes on remand that Verizon Delaware's main complaint is that without relying on its embedded systems as a starting point, it is "impossible to create rates that have any relation to the cost that will be incurred by Verizon-Delaware." *Id.* at 5, quoting Verizon-DE Opening Brief at 49.

Staff argues, however, that:

> seeking such a match is not the goal of TELRIC, which instead is designed to divine economic costs (47 C.F.R. §51.505) and which expressly prohibits the use of embedded costs. 47 C.F.R. §51.505(d)(1). As the District Court stated clearly, the mechanization of Bell's current internal service order processes is irrelevant to the legal standard for determining network element costs.
>
> *Id.* at 6, quoting District Court Remand at 251.
>
> 22. For these reasons, on remand, I recommend that the Commission adopt Staff's interpretation of TELRIC and its position that Verizon-Delaware's NRCM falls short of the TELRIC standard and the District Court Remand.

Hearing Examiner Remand Findings ¶¶ 18-22 (footnotes omitted).

The Hearing Examiner further explained that these conclusions were supported by the testimony of Verizon's own witnesses, who effectively conceded that the Verizon NRCM did not calculate costs based on the most efficient technology currently available, but instead used a "'what Verizon-DE will actually achieve' outlook." *Id.* ¶ 24 (citations omitted). Finally, the Hearing Examiner also agreed with the parties' criticism that the methodology used by Verizon for making so-called "forward-looking" adjustments to its existing processes was effectively a "black box" with no record support. *Id.* ¶¶ 25-26. Thus, even if Verizon's approach of beginning with its existing processes were appropriate, there was no way to judge the reasonableness of the "adjustments" that Verizon purported to make to those existing processes.

For these reasons, the Hearing Examiner recommended that the Commission "reject Verizon-Delaware's proposed non-recurring UNE rates because the NRCM violates the TELRIC pricing standard and the District Court Remand and because

Verizon-Delaware has failed to provide adequate support for the work times used as model inputs." *Id.* ¶ 43.

At its meeting on March 5, 2002, the PSC considered the Hearing Examiner Remand Findings but again failed either to resolve the issue of whether Verizon's NRCM met TELRIC standards and the *McMahon* order or to set a structure for how NRC rates should be set. Rather, the PSC directed Verizon to perform "re-runs" of its cost study. PSC March 5, 2002 Meeting Tr. at 2340, 2354. In particular, as the PSC later described its directive, Verizon was directed to take the survey responses for each task and determine the "average time" which Verizon-Delaware had used in its studies, the "mode time (being the most frequently occurring number in the sample), and the "minimum time" and "maximum time." Order No. 5967 ¶ 88. Verizon was directed to provide results using both its internal survey and the "recently discovered" Andersen survey data. *Id.* On April 9, 2002, Verizon filed the matrix of alternative rate runs (called the "Re-Run Matrix") requested by the Commission at its March 5, 2002 meeting. Verizon amended the filing on April 16, 2002 to correct minor errors. On April 18 and April 22, 2002, the Commission Staff, the OPA, AT&T and Cavalier filed Comments regarding the Re-Run Matrix. Verizon filed Reply Comments on April 25.

At its public meeting on April 30, 2002, the Commission considered the Re-Run Matrix, the Comments, Verizon's Reply Comments, and the oral argument of the parties. There the Commission adopted the Verizon NRCM, adjusted to reflect somewhat lower manual work times than what Verizon had originally proposed. Most of the Commissioners' discussion centered around how much time it should take Verizon employees to perform various tasks using Verizon's existing systems and processes, the same existing systems the Court said were irrelevant to the determination of TELRIC compliant rates. There was no discussion of whether the rates it was adopting were based on the most efficient technology available. Rather, the discussion centered on whether Verizon was using its existing systems in the most efficient way. *See* April 30, 2002 Meeting Tr. at 2414-32. Near the conclusion of the meeting, almost as an afterthought, one Commissioner noted that the rates the PSC was adopting needed to be deemed "TELRIC," as if affixing a TELRIC label to the rates it was approving could somehow paper over it reliance of Verizon's existing systems and processes to set rates. The Commission voted in favor of a motion to apply the TELRIC label. *See id.* at 2435-36.

In its Order No. 5967 memorializing that meeting, the PSC agreed with the criticisms leveled by Staff and AT&T, and the other parties that Verizon's NRCM was flawed. Order No. 5967 ¶ 84. It even acknowledged that "alter[ing]" inputs used in the NRCM, was not the "best way of calculating non-recurring rates," but nevertheless reiterated its finding that the results would be "TELRIC-compliant rates." *Id.* ¶ 85.

On other key issues, Order No. 5967 made no findings. The PSC did not explain: 1) why it was not using AT&T's forward-looking cost model; 2) why the methodological shortcomings in the Verizon NRCM identified by the Hearing Examiner and the parties were not valid; and 3) why, even apart from Verizon's failure to look at the most efficient processes available rather than its existing processes, Verizon's NRCM could be relied upon in light of the Hearing Examiner's express finding that Verizon had not properly supported its purported "forward-looking" adjustments to its existing processes.

In short, when the PSC in Order No. 5967 adopted NRCs based on Verizon's study,[23] the PSC adopted rates based on the same methodology that the District Court

[23] Findings, Op., & Order No. 5967 (June 4, 2002).

found violated the Act, and that it accordingly directed the PSC *not* to use. Walsh Decl. ¶¶ 16-34.

On June 25, 2002, AT&T appealed Order No. 5967 to the U.S. District Court for the District of Delaware—the same court that had issued the *McMahon* decision two years earlier. Complaint for Declaratory and Injunctive Relief, *AT&T Communications of Delaware, Inc. v. Verizon Delaware, Inc., et al.*, Case No. 02-580 (D. Del.). Until the PSC establishes NRCs that actually comply with the TELRIC rules and the District Court's mandate enforcing them, it is premature even to consider Verizon's 271 application in Delaware.

Beyond this threshold defect, Verizon's NRCs suffer from several additional errors. First, Verizon's \$9.01 charge for service order feature changes is unjust, unreasonable and discriminatory. This charge is unsupported by the rate calculation set forth in Verizon's workpapers, and is patently exorbitant. Verizon imposes only an \$0.28 charge to process an *entire UNE-P initial service order*, including whatever features (often multiple) the customer has ordered. *See id.*, line 36. The notion that the TELRIC cost of changing a *single* feature is \$9.01, or 323 times as much, is absurd on its face. In the Delaware state UNE proceeding, AT&T submitted a comprehensive non-recurring cost study showing that a forward-looking feature service order change NRC should be no higher than *27 cents*. Walsh Decl. ¶¶ 42-51. Likewise, Verizon imposes "disconnect" service order charges that were never supported by cost evidence and that, absurdly, are equal to its "connect" service order charges which reflect facilities check costs that do not even occur in connection with disconnects. *Id.* ¶¶ 40-41.

Verizon's Field Installation NRCs also violate TELRIC costing principles and discriminate against CLECs. Indeed, Verizon effectively recovers these costs *twice*, once through recurring charges and again through non-recurring charges. Walsh Decl. ¶¶ 52-64.

The Field Installation activities at issue relate to work between the NID and the central office, such as connecting the feeder cables to the distribution cables (e.g., the field cross-connect at the Feeder Distribution Interface). Verizon imposes Field Installation NRCs when facility paths are not established between the NID and the central office MDF. Verizon included these Field Installation activities in its VZ-DE NRCM cost study on the theory that on its existing network such field activities are *sometimes* "necessary" to fulfill a CLEC's request. Verizon imposes a Field Installation NRCs whenever it chooses to dispatch a technician to complete the CLEC's request. However, Verizon is wrong for assuming these activities are proper NRC activities. Walsh Decl. ¶¶ 52-64.

The loop element as typically and appropriately analyzed in UNE recurring cost analysis, represents a complete transmission facility between the NID and the Central Office. As such, it includes all features, functions, capabilities and connections of such a transmission facility. The forward-looking economic recurring cost of the local loop, reflected by the recurring monthly rate for the use of that loop, includes all of the costs associated with the construction and maintenance of the network including the necessary cross-connections to complete the transmission path. In other words, the UNE loop recurring cost is the cost associated with building and maintaining the transmission facility and is not the cost of laying feeder cable somewhere near distribution cable (to be connected at some later date). Thus, it must necessarily include the cost of this field cross-connect. Without the cross-connect, the loop will not work. Accordingly, Verizon already recovers through its recurring UNE rates the cross-connect costs that it has improperly included in a separate "field installation" NRC. *See id.*

Verizon claims that cross-connect and other field installation activity costs are nonetheless appropriately recovered (or, more precisely, double recovered) through separate NRCs, because those costs are "incurred in response to a specific event initiated by a specific cost-causer and [that] generally involve easily identifiable, concrete costs." Verizon tags the CLEC's service order request as the specific event which "causes" the field installation costs to occur. But that is no response at all to the problem of double recovery – Verizon already recovers the same costs in its recurring charges. Moreover, the continual need to increase, rearrange and maintain network facilities in response to demand increases, maintenance problems and customer moves arises regardless whether consumers are served by the ILEC or a CLEC, so the CLEC is *not* in any meaningful sense the cost causer – indeed, it would be flatly discriminatory to impose "field installation" costs on CLECs based on the fortuity that a cross-connect is required to make the particular UNEs they order operational. Indeed, the field installation NRC *facilitates* anticompetitive discrimination. Verizon controls the assignment of facilities necessary to meet service demands. If multiple facilities are available at particular service address, there is nothing preventing Verizon from assigning facilities that require Field Dispatch, and recovering costs through non-recurring rates, even though connected facilities may already exist. Clearly CLECs are at Verizon's mercy. *See id.*

Verizon invokes the *Local Competition Order* for the proposition that Verizon is "entitled to recover one-time costs caused by a CLEC order on a non-recurring basis from that CLEC," *citing Local Competition Order* at ¶¶ 742–743. In fact, *Local Competition Order* ¶ 743 makes clear that field installation activity is properly recovered in recurring charges. The paragraph draws reference to "charges for dedicated facilities be flat-rated, including, but not limited to, charges for unbundled loops, dedicated transport, interconnection, and collocation." "Flat rated charges" classifies the cost as a recurring cost. Field installation activities are necessary to construct new loops between the NID and the central office, maintain the network, (*i.e.*, repairs), and rearrange the network to meet demand needs (*i.e.*, moves). All of these categories of costs are factored into recurring cost estimates and recovered through flat rate monthly (recurring) charges.

In two recent decisions, state regulators in Verizon's territory have considered and rejected the same arguments that Verizon has advanced in Delaware for its field installation charge.[24] The same result is warranted here.

Finally, Verizon's Delaware hot cut NRC of $35 is not TELRIC-compliant. AT&T recognizes that the Commission has upheld a hot cut rate of $35 in New York and New Jersey, and Verizon presumably filed the same rate in Delaware for that reason. AT&T respectfully submits, however, that the $35 rate is unsupported by any cost study (let alone a TELRIC-compliant study), and the evidence shows that a TELRIC compliant hot cut rate should not exceed $5.00.[25] Moreover, the $35 rate is only temporary. In less

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[24] Massachusetts Department of Telecommunications and Energy, Docket No. DTE 01-20, *Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Pricing, based upon Total Element Long-Run Incremental Costs, for Unbundled Network Elements and Combinations of Unbundled Network Elements, and the Appropriate Avoided-Cost Discount for Verizon New England, Inc. d/b/a Verizon Massachusetts' Resale Services in the Commonwealth of Massachusetts.*, served July 11, 2002, at 420-23; Pennsylvania PUC Docket No. R-00016683, *Generic Investigation of Verizon Pennsylvania, Inc.'s Unbundled Network Element Rates*, Recommended Decision of Administrative Law Judge Michael Schnierle issued May 3, 2002, at 69-70. *See also* Walsh Decl. ¶¶ 59-64 (discussing Massachusetts and Pennsylvania decisions).

[25] *See Application of Verizon New Jersey, Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a/ Verizon Enterprise Solutions), Verizon Global Networks, Inc., and Verizon Select Services, Inc., for Authorization to Provide In-Region InterLata Services in New Jersey, Supplemental Declaration Of Richard J. Walsh On Behalf Of AT&T Corp.*, CC Docket No. 01-347 (filed March 13, 2002).

than two years, Verizon's Delaware hot cut rate will increase to well over $100. Walsh Decl. ¶ 65.

In sum, because Verizon's NRCs in Delaware are based on Verizon's current, inefficient internal order processing system, the NRCs clearly exceed the rates needed to cover the costs of the "most efficient, currently available telecommunications technology currently available and the lowest cost network configuration," 47 C.F.R. § 51.505(b)(1). Stated otherwise, the NRCs are inflated, anti-competitive, and incompatible with the FCC's TELRIC cost methodology and the Act.

IV. VERIZON'S UNE RATES IN DELAWARE CREATE A DISCRIMINATORY "PRICE SQUEEZE" IN VIOLATION OF CHECKLIST ITEM 2.

Section 271 bars the Commission from granting Verizon long distance authority unless the Commission finds that the UNE rates are "nondiscriminatory" as well as cost-based.[26] The Supreme Court has held that even if a utility's wholesale rates are within the range of reasonable cost-based rates, the rates are "discriminatory" and "anticompetitive" if they fall at the high end of that range and if they preclude wholesale purchasers from economically competing with the utility's retail services to any class of customers.[27] Thus, if Verizon's high end UNE rates foreclose UNE purchasers from economically providing residential competition, Verizon is engaged in "discrimination" and has not satisfied checklist item two. And because Section 271 categorically bars long distance authorization unless checklist item two has been "fully implemented," to the extent that Verizon's UNE rates in any state are discriminatory, the Application must be denied.

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[26] *See* 47 U.S.C. §§ 252(d)(1), 271(c)(2)(B)(ii) & (d)(3)(A).

[27] *FPC v. Conway Corp.*, 426 U.S. 271, 278-79 (1976).

The Commission recently offered guidance on the type of "margin analysis" that should be employed to test whether a BOC's rates are, in fact, discriminatory. The Commission explained that, in addition to the revenues that are directly available due to local entry, several other revenue sources would be relevant to a price squeeze analysis including, intraLATA toll and interLATA toll revenue contributions, and the amount of federal and state universal service revenues that would be available to new entrants.[28] The Commission also stated that a margin analysis should consider whether entry is viable using a mix of a UNE-based and resale-based local entry strategy.[29]

AT&T has conducted such an analysis (which accounts for resale, as well as interLATA and intraLATA toll contributions). That analysis confirms that a residential entry strategy that employs combination of UNE-based and facilities-based entry (the analysis assumes that a UNE-based approach where that approach produces the highest margin, and a resale-based approach where that approach produces the highest margin) is *not* economically feasible in Delaware. The state-wide average *gross* margin (not accounting for entrants' internal costs) in Delaware is only $2.79. *See* Lieberman Decl. ¶¶ 42-46.[30] That margin does not even come close to covering an efficient carrier's internal costs of entry. *See id.* As demonstrated in the attached declaration of Stephen Bickley (¶ 2-11), an efficient new entrant's internal costs exceed $10.00 in Delaware.[31]

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[28] *See, e.g., Vermont 271 Order* ¶ 71.

[29] *See id.* ¶ 69.

[30] Verizon also filed a margin analysis. But as explained in the attached declaration of Michael Lieberman, that analysis is fundamentally flawed because it is undocumented and contains several fundamental errors.

[31] In the past, the Commission has questioned whether the well-known internal cost estimate is that of an efficient carrier. The answer to that question is yes. As explained by Mr. Bickley, that internal cost figure does not reflect carriers' *current* internal costs, but their forward-looking costs that accounts for future savings associated with efficiencies and increased scale. *See* Bickley Decl. ¶¶ 1-2.

After accounting for the internal costs of entry, the *net* margins that are available to new entrants in Delaware are *negative*. *See* Lieberman Decl. ¶¶ 42-46. Thus, competitive entry is not feasible in Delaware, which confirms that Verizon's UNE rates are discriminatory in violation of Checklist Item 2.[32]

V. VERIZON'S ENTRY INTO THE INTERLATA MARKET IS INCONSISTENT WITH THE PUBLIC INTEREST.

Even if the Commission could find that Verizon had fully implemented its obligations under the competitive checklist, the record here precludes any finding that Verizon's entry into the InterLATA market in Delaware or New Hampshire would be consistent with the public interest. At the heart of the public interest inquiry, as Congress conceived it and as this Commission has explained, is a determination of whether, notwithstanding checklist compliance, the local market is in fact fully and irreversibly open to competition. Because the Commission cannot make this determination in Delaware and New Hampshire, a grant of section 271 authority is premature and wholly at odds with the fundamental premise of the Act.

A. InterLATA Authorization Is Not In The Public Interest Unless Verizon's Local Markets Are Irreversibly Open To Competition.

As a threshold matter, Verizon "disagrees as a legal matter that the Commission may conduct any analysis of local competition in its public interest inquiry." Verizon Br. 116 n.75. The Commission has previously considered and flatly rejected the argument once again advanced by Verizon:

> "We reject the view that our responsibility to evaluate public interest concerns is limited narrowly to assessing

[32] As demonstrated below, the existence of this price squeeze also confirms that a grant of Verizon's application would contravene the public interest.